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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, OCTOBER 15, 1984 VOLUME XXI, NUMBER 36

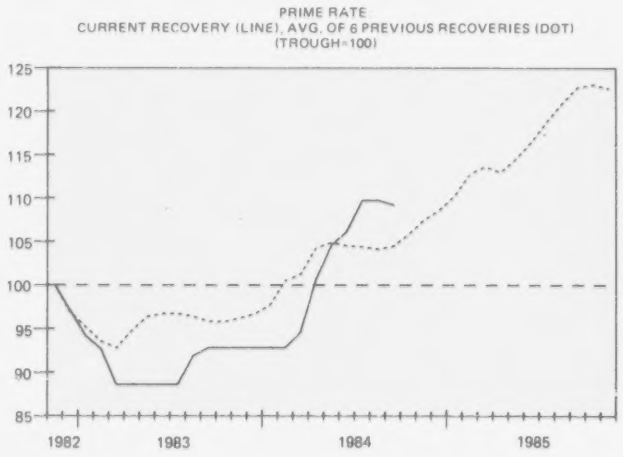
Slower Growth . . .

With the onset of autumn throughout the Northern Hemisphere, both thermometer readings and interest rates are moving lower. Despite earlier fears that rates would be climbing at this stage of the business cycle in response to the one-two punch of a virtually insatiable Federal credit appetite and rising private credit demands, quite the opposite seems to be underway. Fueled by a widespread belief that the Federal Reserve has eased its monetary policy stance, a midsummer pause in the torrid pace of business and the persistence of exceptionally low rates of inflation (Financial Digest—October 5, 1984), rallies in both the money and bond markets have recently sent securities prices higher and yields lower across the entire maturity spectrum.

But while interest rates should remain stable, if not actually drift lower in coming weeks, it still appears a good bet that higher rates are in store for 1985. This is because in the absence of the onset of another recession, it would be most unusual for interest rates to have reached their cyclical peaks this early in the business cycle. Rather, this occurs toward the end of business expansions due to an intensification of credit demands economy-wide, and the refusal of the central bank to accommodate them fully.

One reason for the recent shift in market perceptions, not to mention the anticipated course of interest rates, is the accumulation of evidence that the business expansion is slowing. Trends in employment and hours worked, factory orders and industrial production, as well as in the forward-looking index of leading economic indicators all suggest that a perceptible slowing in the pace of business occurred during the summer. Whereas the economy expanded at an 8½ percent seasonally adjusted annual rate in first-half 1984, by the third quarter of this year, the rate of growth slowed to an annual clip of only around 3½ percent.

What this has done is dampen long-voiced fears that the economy was about to "overheat," with inflation spiking higher—and the Fed tightening the money and credit reins in order to forestall just such a train of events. But while this growth pause was instrumental in pushing down interest rates—not to mention prices at the producer level, which fell in September for the second month in a row—tomorrow's business trends may push interest rates higher.



Take, for example, the state of the consumer. With household confidence remaining bright, buying intentions strong and personal incomes advancing at a good-sized clip, few obstacles stand in the way of higher levels of consumer spending—as evidenced by September's hefty jump of 1.6 percent in retail sales following declines in each of the two previous months. So, too, there are few signs in the business sector that any prolonged spending retrenchment is underway. Capital outlays alone are now advancing at about twice the rate usually experienced at this stage of the business cycle. What is more, with inventories remaining lean relative to sales, any further pickup in consumer spending may well send businessmen scurrying for stocks—fueling even further the pace of economic activity.

. . . Plus A More Generous Fed . . .

This suggests that the midsummer growth pause may be just about over and, if it is, concerns over higher, not lower interest rates will revive. Indeed, as shown in the chart above, such short-term interest rates as the banks' prime lending rate usually rise throughout the expansion phase of the business cycle. Since it is

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unlikely that the current recovery has reached its high-water mark, it is equally unlikely—if the past is any guide—that short-term interest rates have, too.

In the interim, with the pace of business slowing and inflation at the producer level virtually nonexistent, the credit markets are indulging in another vigorous round of speculation as to the near-term course of monetary policy: Will there be less squeeze and more ease? After all, the growth of the M1 money supply was virtually flat all summer long and now stands some $3 billion below the midpoint of its 1984 target range. The year-to-date growth of the M2 money supply as well has moved toward the bottom of its annual target range—suggesting, if nothing else, that the behavior of the money supply numbers does indeed give the Fed wide latitude for some easing of its policy stance.

Against this backdrop, the generous provisioning of reserves to the banking system by the Fed in recent weeks has, if nothing else, certainly led to the appearance of a policy switch toward ease. But, with business activity settling into a slower, albeit more sustainable pace, prices essentially stable and the money supply numbers well behaved, there was actually little reason for the Fed to do otherwise. What is more, the stepped-up pace of reserve provisioning, which may well have been at least partly designed to offset potential seasonal strains on bank reserves, coincided with a pronounced tapering off of short-term business credit demands—

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/10/84	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov't's and Agencies Owned Outright & RPs	159.458	– 2.901	+ .083
Loans to Depository Inst.	6.157	– .016	+ 4.886
Float	.632	+ .133	– .639
Total Reserve Bank Credit	178.365	– 2.782	+ 8.289
Treasury Deposits with Federal Reserve Banks	4.642	– 3.100	– 3.986
Currency in Circulation	177.071	+ 1.398	+12.422
Gov't's held for Foreign Acct. by F.R. Banks (End-of-Week)	116.909	+ .238	+ 7.283
	10/10/84		
Member Bank Reserves:			
Total Reserves Held	38.176	+ .479	+ 3.755
Excess (Deficiency)	1.089	+ .603	+ .360
Net Free Reserves	.644	+ .605	+ .405
Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (10/1/84)	548.3	+ 2.4‡	+ 5.7‡
M2 (September '84)	2,304.7	+ 5.8	+ 7.3
M3 (September '84)	2,885.4	+ 6.9	+ 9.4
Domestic Nonfinancial Debt (2nd Q'84)	5,589.6	+ 12.9	+ 12.4

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 10/12/84	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	9.55%	9.65%	10.75%
* Federal Agencies	10.53	10.76	11.42
* Project Notes—Taxfree (46% Taxable Equivalent)	11.11	11.11	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	10.70	10.85	11.40

‡Finance Company Paper—Prime

5- 14 days	10.10%
15- 29 days	10.33
30- 59 days	10.38
60- 89 days	10.42
90-179 days	10.45
180-239 days	10.45
240-270 days	10.45

‡* Bankers' Acceptances

Nov.	10.45%
Dec.	10.45
Jan.	10.55
Feb.	10.60
Mar.	10.70
Apr.	10.60

‡Industrial Paper—Prime

30- 89 days	10.20%
90-120 days	10.00

†Federal Funds Effective Rate 9.95%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'84	$ 3,645	$ 3,553	$ 3,267
Gross National Product (1972 Dollars)*	2nd Q'84	$ 1,639	$ 1,611	$ 1,525
Percent Change, Annual Rate	2nd Q'84	7.1	10.1	9.4
Change in Consumer Prices (new series)*	Aug '84	6.0%	3.6%	4.8%
Change in Producer Prices*	Sep '84n	– 2.4%	– 1.2%	1.2%
Civilian Employment (Thousands of Persons)†	Sep '84	105,239	104,969	101,876
Unemployment as % of Civilian Labor Force†	Sep '84	7.4%	7.5%	9.2%
Personal Income*	Aug '84	$ 3,043	$ 3,027	$ 2,760
Leading Indicators Composite Index (1967=100)†	Aug '84	164.5	163.7	158.9
Industrial Production Index (1967=100) †	Aug '84	166.2	165.8	151.8
Net Change in Consumer Installment Credit †	Jul '84	$ 7.11	$ 7.83	$ 3.71
U.S. Merchandise Trade Balance †	Aug '84	–$ 9.86	–$ 14.06	–$ 7.16
Plant and Equipment Expenditures*	4th Q'84	$318.33(a)	$316.22(a)	$283.96
Private Housing Starts (Thousands of Units)*	Aug '84	1,537	1,763	1,873
New Construction Expenditures*	Aug '84	$ 311.7	$ 311.2	$ 278.0
Total Business Inventories †	Jul '84	$ 551.3	$ 546.8	$ 501.4
Total Business Sales †	Jul '84	$ 411.0	$ 414.1	$ 370.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

setting the stage for lower interest rates.

. . . Equals Lower Interest Rates

With merger and acquisition activity moderating and growth slowing, the effects on commercial and industrial loan demand were not long in coming. Over the past three months, commercial and industrial loans outstanding rose by about $2½ billion, or an approximately four percent annual rate. This is well below the almost $12½ billion, or 21½ percent annual rate of rise posted over the immediately preceding three-month period. And, although the issuance of nonfinancial company commercial paper remains brisk, the anemic growth of C & I loan demand in recent months reduced the need for bank reserves at precisely the same time that the Fed was supplying more of them. In fact, the slowing of the pace of business borrowings was undoubtedly the key ingredient in taking some of the heat off the credit markets.

Putting all this together—the slowing pace of business and business borrowings, little or no inflation, well behaved money supply numbers and a tolerance by the Federal Reserve of lower interest rates—and it is not surprising that money market rates have dipped. But business activity and private credit needs are likely to soon perk up. And there is a hefty slate of Treasury borrowings on tap. If the Fed is unwilling to accommodate fully all of these growing credit needs, then higher interest rates appear likely.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (9/26/84)	159,703	+ 2,605	+12,571
New York City (10/3/84)	34,868	– 56	+ 4,166
Commercial Paper (10/3/84)	227,659	+ 468	+50,749

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/26/84)	244,040	– 2,028	+28,753
New York City (10/3/84)	64,942	+ 823	+ 7,124

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/26/84)	623,379	– 2,809	+93,001
New York City (10/3/84)	140,870	+ 1,368	+20,498

Financial Markets

	Friday 10/12/84	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	10.30%	– .26	+ 1.25
180-Day Bills†	10.70	– .26	+ 1.25
Longest Bills†	11.00	– .33	+ 1.17
Recent Issues:			
11⅞s 9/30/86	11.68	– .28	
13⅝s 6/30/88	12.05	– .30	
12⅝s 8/15/94	12.25	– .21	
12½s 8/15/14	12.10	– .18	
Municipals:			
Bond Buyer–20 Bond Index* (10/11/84)	10.36%	+ .02	+ .69
Blue List Total ($ Million)	$1,631	– $124	+ $ 195
30-Day Visible Supply ($ Million)	$3,395	– $299	+ $1,181
Total	$5,026	– $423	+ $1,376
Corporates:			
Moody's Aa Composite (10/11/84)	13.25%	– .02	+ .69
30-Day Visible Supply ($ Million)	$ 849	– $606	– $ 893
Stocks:			
Dow-Jones Averages:			
Industrials	1,190.70	+ 8.17	– 72.82
Transportation	517.40	+ 2.37	– 63.15
Utilities	140.75	+ 2.47	+ 3.37
65 Stocks	471.06	+ 3.70	– 31.00
Standard and Poor's 500 Stocks	164.18	+ 1.50	– 5.68
N.Y.S.E. Composite Index	94.79	+ .90	– 3.21
N.Y.S.E. Avg. Daily Vol. for Week (000's)	79,410	– 3,718	+ 7,060

* 46% Taxable equivalent 19.19%.

† Bond equivalent.

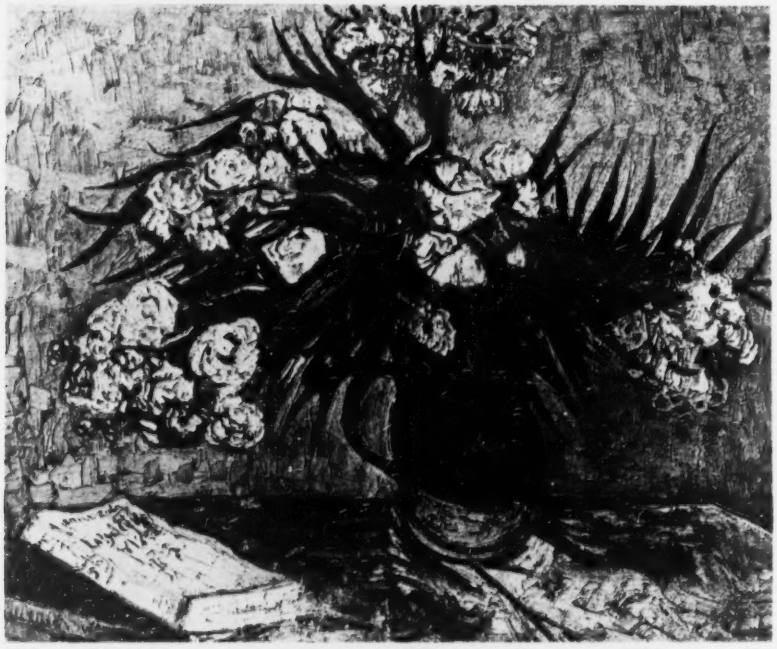
International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/12/84	Week Ago
Overnight	9.88%	10.38%
1 month	10.56	10.94
3 month	11.06	11.38
6 month	11.31	11.56
1 year	11.69	11.88
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	12.60%	12.60%
Long Term (7 to 15 yrs.)	12.60	12.55

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/12/84)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01593	62.77
Canada	.7581	1.3191
Denmark	.08905	11.2300
France	.1051	9.5175
Germany	.3221	3.1050
Italy	.0005219	1916.00
Japan	.004040	247.55
Mexico	.005000	200.00
Netherlands	.2858	3.4990
Switzerland	.3923	2.5490
U.K.	1.2260	.8157

VAN GOGH



IN ARLES

The Metropolitan Museum of Art
October 18-December 30, 1984

Sponsored by Manufacturers Hanover
and the Robert Wood Johnson, Jr. Charitable Trust

This exhibition gathers over 140 van Gogh works of art that have never been seen together before, and Manufacturers Hanover is pleased to help make it possible.

All visitors must have a ticket for a reserved date and time. Tickets available at the Uris *Center of the Museum* during all public hours. Also through *Ticketron* and *Tele-Tron*, a telephone service that accepts reservations with major credit cards. For ticketing information, call 570-3970.

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